

1998 U.S. Region Pricing Changes

Randy Norris, Vice President, U.S. Region Financial Officer

Proposal

To approve the recommended changes to the U.S. Region Pricing Program which will be presented at the October 9th U.S. Board meeting.

Background

Each year, MasterCard conducts a full review of its regional pricing, and submits recommended changes to the Board for approval. All pricing changes (other than new MasterCom fees) will be effective on April 1, 1998, applicable to second quarter 1998 volume, regardless of when actual billing occurs.

The 1998 pricing strategy was designed using the following objectives:

- Reward and incent members for incremental volume
- Pass operating efficiencies to members via lower prices
- Continue user pay philosophy, pricing on value rendered

Analysis and Recommendations

Revenues are forecasted to grow 17% to \$760 million which will allow the U.S. Region to adequately promote the MasterCard brand, meet our budget commitments to the company and pass along an approximate 2.5% - 3% net price reduction to the membership. The following price reductions are recommended:

- Reduce Issuer Assessments to all members by combining the first two tiers at the lower rate of \$0.65 per \$1,000 and significantly reducing fourth tier volume, further incenting and rewarding members for incremental volume. In addition, a flat rate for cash of \$0.20 is recommended. (Please refer to schedule A)
- Reduce the Electronic Warning Bulletin (EWB) rate to \$0.50/account/week from \$0.80/account/week to reduce costs for all issuers in managing fraud and risk.
- Reduce the Supermarket Investment Fee, from 15bp to 10bp to reduce costs for all issuers in this rapidly expanding acceptance market.

These fee reductions will save MasterCard members \$33MM annually (approximate 5% reduction) and improve profitability for every MasterCard issuer.

P-0453

Consistent with the user pay philosophy, several fees have been modified to help cover the actual costs of these services as well as to reflect the value they bring to members. These fees have a total 1997 member impact of approximately \$10 million annually and include:

- **Call Referral Fees - Franchise Management**, based on input from the IOC, has developed a Global Automated Referral Service (GARS) to provide members with global coverage for referral processing and facilitate reduced response times at the point of interaction (POI). In order to recover GARS development and management costs as well as reflect the value of the service, an additional response fee of \$6.50 for each call referral processed via ARS/GARS is recommended. This fee would apply only to completed call referrals. The response fee, in most cases, replaces the more expensive telex costs which average approximately \$15.50. The current issuance fee of \$2.50, and the acquirer reimbursement fee of \$1.50 remain unchanged. Issuers will not be charged for duplicate call referrals which occur when the merchant and/or acquirer make additional attempts to obtain an authorization.
- **BIN Fees- Implement a new fee for "Minimal Traffic" BINs** of \$1,000 per quarter and increase the inactive BINs fee of \$100/year to \$1,000 per quarter to incent members to return BINS to MasterCard. The current fee of \$100/year for active BINs still applies. While last year's attempt to reclaim unused BINs from members was somewhat successful by charging \$100 per annum, not all BINs were returned. Therefore, staff recommends increasing the fee to members still in possession of inactive BIN numbers to ensure all inactive BINs are returned to MasterCard. Members should also consider returning minimal traffic BINs to MasterCard. Minimal traffic is defined as any BIN having less than 1,000 transactions per quarter.
- **QMR Late Fees - To incent timely reporting of QMR data**, in addition to the current \$500 late fee per quarter per member, a new fee of \$100 per day is recommended until all parts of the QMR have been properly filed.
- **Global Service Center Emergency Card Replacement (ECR) and Lost and Stolen Card Reporting (LSR) - MasterCard Global Services** enables traveling cardholders to access, via a toll-free number, core emergency and special services, anytime, anywhere, in any language. Recently, a new feature was added; an automatic receipt statement for every ECR/LSR transaction is delivered so issuers are notified when their cardholder receives their new card, or reports their card lost or stolen. The proposal is to increase the fee to recover costs of providing the service and reflect the value this service brings to MasterCard cardholders and members; increase ECR to \$105 plus telecommunications from \$95 for US issued /US delivered cards and to \$148 plus telecommunications from \$135 for US /issued internationally delivered cards. LSR would be increased to \$35 per call plus telecommunications from \$20.

- Expansion of Enhancement Services Call Fee for insurance benefits and other services - MasterCard currently absorbs the majority of enhancement services costs associated with all MasterCard cards that have mandatory benefits associated with the particular card program (e.g. Gold MasterCard Purchase Assurance, MasterRental (CDW), Extended Warranty). MasterCard currently spends in excess of \$18MM/year to provide these benefits on behalf of our members, and currently recovers only \$3.2MM of that expense. This revenue is currently generated by a \$5 plus telecommunications cost per call for calls referred to issuers (or their vendors) customer service centers for appropriate handling. Staff recommends the current \$5 plus telecommunications cost referral fee per call to apply to insurance benefit calls and other service calls as well.
- MasterCom Pricing - MasterCom, the document exchange system used to transmit sales slip images, has historically lost money since its inception. In July of this year, the Global Board agreed that movement to a cost recovery strategy is appropriate. Subsequently, new MasterCom pricing was announced to the membership in August 1997, with an effective date of January 1, 1998 pending approval of the regional boards. Revised pricing allows MasterCard to recover the cost of operations and will allow members to own and manage their own computer hardware configurations when MasterCom II becomes available. (Please refer to attached MasterCom News) Member reaction to MasterCom improvements and revised pricing has been extremely positive.

Finally, as a result of the changing environment within the Acquirer segment, there is likely to be an increasing number of On-Us transactions. Presently MasterCard does not charge acquirers for On-Us transactions. With the potential increase in On-Us volume, this change could result in a \$6 million revenue loss in 1998. To address this issue, management proposes that, effective April 1, 1998, a new Brand Volume Fee, paid by Acquirers, be implemented. This new fee would be based on data collected on all outgoing volumes for all domestic and international Interchange retail and cash volumes and on Non-Interchange On-Us retail volume. The rate will be US \$0.95 per \$1,000 of volume. MasterCard will use data collected via INET, intra-processor and collection only reporting to bill and collect this fee on the last day of each month beginning April 30, 1998. It will therefore be appropriate to discontinue the existing assessments on acquiring volume, which are currently billed quarterly and includes local and international outgoing volumes effective midnight March 31, 1998. All members with acquiring volume will still be required to pay the former Assessments due April 15, 1998 as normally calculated based on volume between 1/1 - 3/31/97 through the normal collection process. The member impact from these changes is minimal, arising from the fee impact from On-Us transactions which totals approximately \$6 million annually, and the change in the timing of payments called for by the Brand Volume Fee.

RESOLUTION OF THE U.S. BOARD OF DIRECTORS

RESOLVED, that the U.S. Pricing Program changes, as presented to the U.S. Board at this meeting, be, and hereby are, approved.

RESOLVED FURTHER, that MasterCom Fees, as announced to the general membership in August 1997, and presented to the U.S. Board at this meeting, be, and hereby are, approved and shall take effect on January 1, 1998.

Reduce Issuer Assessment

Schedule A

Recommendation	Current			Proposed	
<ul style="list-style-type: none"> • Reduce Issuer Assessment <ul style="list-style-type: none"> – Reduce rates by eliminating Tier 1 and assessing the lower Tier 2 rate – Saves all members \$0.10 on first tier retail volume – Lower 4th & 5th Tier volume adjusted to reward & incent incremental business – Establishes NEW low rate of \$0.20 for cash 	Retail And Cash			Retail	
	<u>Tier</u>	<u>Volume</u>	<u>Fee</u>	<u>Volume</u>	<u>Fee</u>
	1	First 148MM	\$0.75	First 500MM	\$0.65
	2	Next 431MM	\$0.65	Next 500MM	\$0.55
	3	Next 493MM	\$0.55	Next 500MM	\$0.45
	4	Next 469MM	\$0.45	Next 1,500MM	\$0.35
	5	Next 2,603MM	\$0.35	Over 3,000MM	\$0.25
	6	Over 4,144MM	\$0.25	Cash	
				ALL CASH \$0.20	